

Special points of interest:

- Treasury began Sales and Use Tax audits
- Upcoming expiration of the 1998 Tax Incentives Act
- Recent tax publications and rulings

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Someone is Knocking on Your Door

By Juan C. Zaragoza

Time flies when you are having fun as well as when you are trying to cope with a new tax system. The first anniversary to the Sales and Use Tax is on November 15 of this year and Treasury didn't wait 'til that date to begin the celebration. Just a couple of months ago they began an audit initiative whereby around one hundred taxpayers were selected for a Sales and Use Tax Audit. It is expected that they will expand this program to include additional taxpayers, especially those in industries believed to be in low compliance based on the results of prior audits.

Always remember that if you fail to collect the SUT, you are the person principally responsible for the tax. In addition, keep in mind that the SUT audits have the particularity that they focus on both the purchases and sales of your business. What we have seen in the audits we have handled so far is that Treasury will look at your fixed asset's additions as well as inventory purchases, from one side and on the other side will also look at the exempt sales, inventory withdrawals and obsolescence reserves, among other things. As with any celebration, the best way to approach it is to do the necessary housekeeping in order to have everything in order for the guests. However, in the case of taxes, especially



those in which you are just a collection agent and in which by the time you get audited, the real taxpayer, the consumer, is already long gone, the best housekeeping is making sure you obtain the necessary documentation contemporary with the sale. In order to do this, it is imperative to have a clear understanding of the SUT provisions of the Internal Revenue Service Code, especially those which allow merchants to sell without the imposition of the SUT. Example of these provisions are those related to manufacturers, resellers and certain entities which enjoy partial exemptions like hospitals and hotels. Once you feel comfortable with your records, or at least you have decided that there is nothing more you can do about it, it is time to begin thinking on the sampling process. It is pertinent to mention that the SUT provisions of the Code include, for the first time ever, an authoriza-

tion for the auditor to use sampling, not just as a mechanism to get an idea of the frequency and magnitude of errors, but as the basis to impose a deficiency based exclusively on the results of the sample.

However, this is not a one sided process. The Code requires that the Secretary must reach an agreement with the taxpayer regarding the parameters of the sample. However, even if an agreement is reached, this does not mean that the taxpayer should accept without remarks the resulting deficiency. Taxpayers should evaluate in detail the results of the sampling process and point out to the auditor, any extraordinary or infrequent transactions which were selected in the sample but which do not represent fairly the characteristics of the universe. An example of this would be the selection of a transaction with a failure to collect the SUT on a ten thousand dollars sale, when the average sale of the client is around one hundred fifty dollars. We believe it would be reasonable to request the stratification of the sample, carving out such transaction and extrapolating the sample results without taking into consideration such transaction.

In summary, the party has just begun and it seems it will take a while before it is over. If they have not knocked on your door, you should begin the housekeeping as soon as possible. If they never visit you, at least you cleaned the house.

1998 Tax Incentives Act Will Expire Next December 31, 2007

By **Sandra Marie Torres**

As of today, a Bill for the extension of the 1998 Tax Incentives Act ("1998 TIA") has not been approved nor has a new Tax Incentives Act been enacted. This, together with the fact that Section 21 of the 1998 TIA, provides that applications for industrial tax exemption will be received by the Office of Industrial Tax Exemption up to December 31, 2007, has created confusion in terms of the effective termination dates of the tax incentives included in existing tax exemption grants. Although some may think that the fact that no more applications for tax exemption under the provisions of the 1998 TIA may be filed after December 31, 2007 *may* have an impact on the expira-

tion dates for the tax incentives included in existing tax exemption grants, **this is not true.**

The expiration dates of existing tax exemption grants are those included in such binding documents and will not be affected by the fact that the 1998 TIA **expires** on December 31, 2007. As a matter of fact, there are still entities that enjoy tax exemption under predecessor acts which have also expired.

Then why, you may ask, are so many entities that currently hold a tax exemption grant issued under the provisions of the 1998 TIA requesting new grants? Generally, to be able to extend the exemption period for several years (depending on the location of its operations) beyond the

existing expiration date, just in case a new law is not enacted. Section 8 of the 1998 TIA allows for the renegotiation, conversion or extension of current tax exemption grants and provides the requirements that must be satisfied under each option.

Requesting a new or renegotiated grant can be an option, especially for grantees with exemption grants expiring in the next two or three years. By doing so they would address the risk of not being able to enjoy tax exemption if a new tax exemption law is never approved (risk which we believe is slim). Even if a new law is approved, tax exemption laws usually provide for existing grantees to convert their tax exemption grants to the new law, thus giving them the opportunity to upgrade (to the extent better benefits are available) their existing tax grants.



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Recent Publications Issued by the Puerto Rico Secretary of the Treasury

By **Rafael A. Carazo**

As a result of several amendments to the Puerto Rico Internal Revenue Code related to the Sales and Use Tax, the Puerto Rico Secretary of the Treasury issued various Informative Bulletins to explain or clarify the extent of the amendments. Following we will summarize those bulletins.

IB No. 07-16 RE: Exemption to Medical Equipment

Act No. 61, enacted on July 12, 2007, amended sections 2301 and 2512, and added section 2516 to the Code to expand the exemption from the payment of the Sales Tax granted to prescribed medications by modifying the definition of prosthesis, which is included in the exemption. The Act also

provides for a new exemption to certain equipments, materials, and articles acquired by entities that provide health or medical services.

To inform of the changes made by Act No. 61 to the Code, the Secretary issued IB No. 07-16. Said IB also explains how those changes affect or apply to the sellers and to the purchasers of the exempt goods. It also establishes the procedure that the entities must follow to validate the exemption granted by said Act.

IB No. 07-19 RE: Exemption to Funeral Services

Act No.76 of July 23, 2007, added section 2514 to the Code to provide a new Sales Tax exemption to funeral services up to \$4,000.

The IB No. 07-19 informs of the changes introduced by said Act and clarifies the services that are covered by the exemption. On the other hand, it also states that any cost related to the acquisition of any real property made in connection with a funeral (such as a lot or structure in a cemetery) will not be included in the \$4,000 exemption limitation, because real property, by definition, is not subject to the Sales Tax.

IB No. 07-19 RE: New Rules Regarding the Collection and Payment of the Sales Tax

The IB No. 07-19 was issued by the Secretary to summarize the rules applicable to the collection and payment of the

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New Rules Regarding the Sales and Use Tax

By Rafael A. Carazo

On July 29, 2007, the Governor of Puerto Rico signed House Bill 3190, which became Act No. 80. This Act amended several provisions of the Puerto Rico Internal Revenue Code to simplify the rules applicable to the collection and payment of the Sales and Use Tax imposed by the municipalities. In view of the approval of Act No. 80, the Puerto Rico Secretary of the Treasury issued Regulation No. 7392 to address the amendments that Act No. 80 made to the Code. Following we summarize the most relevant changes introduced by Act No. 80.

I. Uniform Sales Tax Rate and Rules

Act. No. 80 requires that all the municipalities in Puerto Rico impose a 1.5% Municipal Sales Tax. Thus, effective July 29, 2007, there cannot be municipalities with no Sales Tax or with a Sales Tax at a lower rate. Of said 1.5% Sales Tax, the municipalities will collect 1%, either directly or through a third party (which could be the Treasury Department). The remaining 0.5% will be collected by the Secretary.



Furthermore, the 1% Sales Tax imposed by the municipalities is subject to the same rules related to the tax base, exemptions and limitations that apply to the 5.5% General Sales Tax that the Secretary has been collecting since November 15, 2006, except with respect to unprocessed food. Act. No. 80 allows the municipalities to impose a 1% Sales Tax to unprocessed food, which is not subject to the General Sales Tax.

II. Breakdown of the Sales Tax no Longer Required

The Regulation provides that any person required to collect the 7% Sales Tax does not have to show in the sales receipt a breakdown of the Sales Tax collected (i.e., the General and the Municipal Sales Taxes). If however, the person desires to show it, the breakdown must be 6% (state level) and 1% (municipal level).

III. Nexus and sourcing rules

The rules related to nexus are used to establish whether a person has sufficient presence in a jurisdiction (i.e., a country) to make that person subject to the laws (including tax laws) of that jurisdiction.

On the other hand, the sourcing rules are used to determine the jurisdiction to which a transaction must be attributed for taxing purposes. Before the Regulation was issued, the applicability of the nexus and sourcing rules to transactions involving various municipalities (e.g., the sale was made in one municipality while the article purchased was delivered to another municipality) created several doubts and situations regarding the municipality that was entitled to receive the Sales Tax collected.

In order to avoid the above situation, the Regulation eliminated the applicability of the nexus rules to the municipalities. Accordingly, the nexus rules will be exclusively used to determine whether a person has nexus with Puerto Rico.

Similarly, the Regulation provides that for purposes of the sourcing rules, there is only one jurisdiction, Puerto Rico. Accordingly, the sourcing rules will not apply to transactions among municipalities, but just to transactions with other countries.

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In a nutshell...

1. Act. No. 80 requires that all the municipalities in Puerto Rico impose a 1.5% Municipal Sales Tax.
2. The Regulation provides that any person required to collect the 7% Sales Tax does not have to show in the sales receipt a breakdown of the Sales Tax collected.
3. The Regulation eliminated the applicability of the nexus rules to the municipalities. Accordingly, the nexus rules will be exclusively used to determine whether a person has nexus with Puerto Rico.
4. The Regulation provides that for purposes of the sourcing rules, there is only one jurisdiction, Puerto Rico. Accordingly, the sourcing rules will not apply to transactions among municipalities, but just to transactions with other countries.
5. Under the Regulation, a person is required to file a monthly sales tax return only for that municipality in which it has a place of business, unless it has a place of business in more than one municipality, in which case a return must be filed for each municipality.

Recent Publications... Continued from Page 2

Sales Tax, including the filing of the monthly return in various situations. The clarifications made therein were pertinent in view of the changes that were made to those procedures by Act No. 80 of July 29, 2007, and Regulation 7392 issued on July 31, 2007. See the related article on this page.

Renewing Your Company's Internal Revenue License? Be proactive and avoid a nervous breakdown.

By Carlos R. González

By the time you are reading this newsletter, you are probably done with the tedious process of the renewal of the company's internal revenue license, be it a license for the sale of jewelry or cigarettes, a transport license, a license for the operation of entertainment machines, or any other license.

There are many documents required for the renewal of these licenses, among them: a continuous bond, copy of the lease agreement (if applicable), audited financial statements, a Good Standing Certificate, and filing and tax debt certificates.

New Rules Regarding... Continued from Page 3

IV. The Sales Tax return

Under the Regulation, a person is required to file a monthly sales tax return only for that municipality in which it has a place of business. If it has a place of business in more than one municipality, a return must be filed for each municipality including the corresponding Municipal Sales Tax (1%). It must also file a monthly return with the Secretary and pay the remaining amount of Sales Tax collected (6%).

However, if the municipality where the place of business is located has entered into an agreement with the Secretary under which the Secretary will collect the Municipal Sales Tax on its behalf, then the person will file the return with the Secretary and remit to him the total Sales Tax collected (7%).

One of the problems you face every year with these licenses is that the filing and tax debt certificates from the PR Treasury Department (PRTD), the Municipal Revenue Collection Center (MRCC) and municipal license tax, must show no taxes owed and must confirm that all tax returns have been filed. The same happens with the requirement for a Good Standing Certificate, which must confirm compliance with all the filings at the Department of State. In many occasions this is not the case, and by the time the renewal is due you find yourself looking for evidence in order to update the records and obtain clean certificates and a corrected Good Standing Certificate while the clock keeps ticking.

Having complete documentation is important in renewing these licenses because, in some cases, discounts are offered for completing the process by September 30. On the other hand, as expressed by the Se-

cretary of the Treasury in Circular Letter 07-14 of September 14, 2007, there is no extension of time provided for the payment of the license fee and a late submission will be subject to fines and penalties in an irrevocable manner.

Now is the time to be proactive. Instead of waiting for the last moment to find out that the records of the company are not updated in the governmental agencies' records, plan ahead. Here are some tips of how you can be proactive and avoid a last minute crisis:

- To the extent possible, when filing tax returns and reports, hand-deliver them and obtain a stamped copy for your records. This will facilitate obtaining a corrected certificate of filing with the PRTD and the MRCC, or a corrected Good Standing Certificate, if needed.

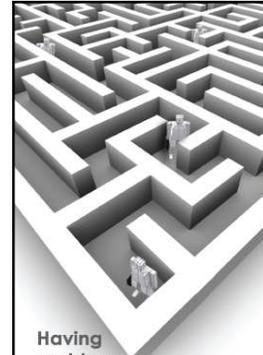
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Taxand is the Best Represented Tax Network at the European Tax Awards

By Taxand Editorial Staff

Taxand, the first global network of independent tax advisors was recently highly rewarded at the third annual European Tax Awards, which aims to reward excellence among European tax firms. Three Taxand members were named "Tax Firm of the Year" 2007 in their respective countries by the International Tax Review, the world's most authoritative and lively magazine dedicated to international tax strategy: ATOZ (Luxembourg),

BECH BRUNN (Denmark) and GARRIGUES (Spain). This title is awarded each year to a tax advisory firm recognized on its market for the quality of its professional services. With three other members of Taxand also nominated in this category (GARRIGUES in Portugal, BORENIUS & KEMPINEN in Finland and PEPELIAEV, GOLTSBLAT & PARTNERS in Russia), Taxand is the best represented independent tax network this year at the ITR European Tax Awards.



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New Social Security Wage Base for 2008

By Carlos R. González

The Social Security Administration announced the new wage base for computing the social security tax in 2008 of \$102,000. This announcement marks the first time the wage base for social security withholding purposes exceeds \$100,000.

Renewing Your Company's... Continued from Page 4

- Request certificates of tax debt from the PRTD and the MRCC every three months. This will allow you to attack the tax deficiencies promptly.
- Verify the status of your account with the municipality where the company is doing business. Some municipalities do not send the municipal license if the company's records show tax debts.
- Request the Good Standing Certificate at least three months before the license due. The Department of State has an increased number of records to keep and to certify, and they are taking longer to issue these certificates. Three months should be enough time for the issuance of the certificate, and its correction if needed.
- Ascertain the name of the company is correct and is the same in all the certificates. The PRTD might challenge the submission of the license renewal if the name in the certificate does not match with the correct name of the entity.

Sandra M. Torres Promoted to Partner at Zaragoza & Alvarado LLP

By Z&A Editorial Staff

The Partners of Zaragoza & Alvarado LLP recently announced the promotion of Sandra Torres to Partner, effective October 1, 2007. Torres, who joined Z&A in 2002, has over 16 years of experience in the tax consulting and compliance areas. She also holds a BBA degree from the University of Puerto Rico and is a Certified Public Accountant.

quality of work and a genuine interest to the community



"Sandra's promotion to Partner is a reflection of the value of her contributions to the Firm. She has demonstrated a commitment to client service,

which are consistent with the core values of our organization", said co-founder and Managing Partner Juan Zaragoza.

Z&A's Sandra M. Torres Community Involvement Recognized During PRCPA Convention 2007

By Z&A Editorial Staff

The Puerto Rico Society of Certified Public Accountants recently celebrated its Annual Convention 2007. This year, Z&A not only re confirmed its position as a leader in the tax field by conducting the Convention's Tax Seminar for a third consecutive year, but had Partner Sandra M. Torres recognized by the organization with the Service to the Community Award, for her dedication and commitment with the Puerto Rican society.

CREATE and Fundación Becas Padre Claro. Through them, she keeps herself in contact with children and adolescents, supporting and pro-



Celebrating with Sandra M. Torres (left to right) Partners Juan Alvarado, Felipe Mariani, Edgardo Sanabria and Juan Zaragoza.

For years, Mrs. Torres has been involved with different community action organizations such as

moting the organizations mission of helping others by offering alternatives for the development of their emotional and social potential and their commitment to learning.

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Backed up by years of unmatched hands-on experience in public accounting, government and corporate tax, our team of tax consultants is redefining the market by providing professional tax and business advisory services through its "top-heavy" structure, designed specifically to provide high level tax consulting to our clients on a more personalized basis.

Zaragoza & Alvarado LLP is a proud member of Taxand, the leading provider of completely independent tax consulting services.

Taxand

Taxand is the leading provider of completely independent tax consulting services, with more than 1,750 tax professionals, including 300 international partners in 39 countries.

Globalization and complexity impose deep expertise, specialization and flexibility. That is the reason why independent and specialized tax firms decided on February 9th 2005 to create Taxand, in order to serve local and international clients.

The Taxand Advantage

While Taxand is new to the industry, Taxand professionals are not. We bring deep knowledge, proven track records and decades of experience in tax services. One of the major advantages of Taxand is independence. We do not have independence conflicts which might threaten our objectivity or compromise the integrity of a client's operations or decisions.

We optimize clients' businesses by anticipating, measuring and managing tax implications of their day-to-day operations and strategic decisions.

Specialization is key. Business operations and global tax legislation are getting more and more complex. Deep tax expertise is needed to help clients identify, measure, and manage tax implications and risks within their operations. Our model is to specialize our people on Tax only and liaise with any other expertise (Legal, M&A, Finance, Risk Management, Technology...) whenever it is needed by clients.

Different from other international networks such as international law firms or big four firms, our core practice is tax, so every investment we make is in the tax practice rather than in other competencies that may seem more important to other firms.

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